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In the Supreme Court of the United States

OCTOBER TERM, 1998

RALPH R. MABEY, CHAPTER II TRUSTEE FOR CAJUN ELECTRIC POWER COOPERATIVE, INC., ET AL., PETITIONERS

v.

SOUTHWESTERN ELECTRIC POWER COMPANY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals erred in holding that certain payments made by a plan proponent in a Chapter 11 (11 U.S.C. 1101 *et seq.*) bankruptcy proceeding to the debtor's cooperative members did not warrant disgorgement or disqualification of the proponent's plan.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	7
Conclusion	12

TABLE OF AUTHORITIES

Cases:

Bank of America Nat'l Trust & Savings Ass'n v. *203 North LaSalle Street Partnership*, No. 97-1418 (argued Nov. 2, 1998)	10
Bowman v. *Loperena*, 311 U.S. 262 (1940)	2
Cajun Elec. Power Coop., Inc., In re:	
74 F.3d 599 (5th Cir.), cert. denied, 519 U.S. 808 (1996)	3
119 F.3d 349 (5th Cir. 1997)	3
230 B.R. 715 (Bankr. M.D. La. 1999)	10, 12
Norwest Bank Worthington v. *Ahlers*, 485 U.S. 197 (1988)	10
Official Comm. of Equity Security Holders v. *Mabey*, 832 F.2d 299 (4th Cir. 1987), cert. denied, 485 U.S. 962 (1988)	8
United States v. *Knight*, 336 U.S. 505 (1949)	8, 9, 10
United States v. *Johnston*, 268 U.S. 220 (1925)	9-10

Statutues:

Rural Electrification Act of 1936, 7 U.S.C. 901 *et seq.*	2
Bankruptcy Code, 11 U.S.C. 101 *et seq*:	
Ch. 11, 11 U.S.C. 1101 *et seq.*	2, 5
11 U.S.C. 1123(a)(4)	6
11 U.S.C. 1125	6, 7
11 U.S.C. 1129	6

Statutues—Continued: Page

11 U.S.C. 1129(a)(3) 6
11 U.S.C. 1129(a)(4) 5, 6, 12
11 U.S.C. 1129(b)(2)(B)(ii) 6, 10

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-36a) is reported at 150 F.3d 503. The opinions of the district court (Pet. App. 40a-79a) and of the bankruptcy court (Pet. App. 82a-89a) are unreported.

JURISDICTION

The court of appeals entered its judgment and issued its mandate on August 11, 1998 (Pet. App. 1a, 36a). Petitions for rehearing, which the court of appeals circulated to the full court and which were treated as "motions to recall the mandate in order to restore jurisdiction to the Court of Appeals to enable the court to consider such Petitions," were denied on October 29,

1998 (Pet. App. 90a-91a). The petition for a writ of certiorari was filed on January 27, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).[1]

STATEMENT

1. Cajun Electric Power Cooperative (Cajun) is a non-profit, rural electrical generation and transmission cooperative. Cajun's twelve distribution cooperative members/owners provide retail electrical service to customers residing in Louisiana. Pet. App. 2a. The Department of Agriculture's Rural Utilities Service provides financial assistance, in the form of loans and guarantees, to rural electric providers in order to bring electric power to parts of the country that are not adequately served by commercial utility companies. See Rural Electrification Act of 1936, 7 U.S.C. 901 *et seq.* The United States, through the Rural Utilities Service, has provided Cajun billions in loans and guarantees. See Pet. 5.

In 1994, Cajun filed for bankruptcy, seeking reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101 *et seq.* The United States, which is owed approximately $4.2 billion, is the largest of Cajun's 700 creditors. Pet. 5; Pet. App. 2a. Cajun's primary source of revenue—and thus the bankruptcy estate's most

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[1] Respondents Southwestern Electric Power Company and the Committee of Certain Members of Cajun Electric Power Cooperative argue (Br. in Opp. 9-10) that the court of appeals' immediate issuance of the mandate rendered the petitions for rehearing ineffective to toll the time for filing the petition for a writ of certiorari and thus that the petition is untimely. We disagree. The court of appeals allowed the petitions for rehearing to be filed and circulated and considered them on their merits, rather than dismissing them outright. The time for filing a petition for a writ of certiorari thus ran from the denial of the petitions. See *Bowman* v. *Loperena*, 311 U.S. 262, 266 (1940).

valuable asset—is its sale of wholesale electric power to its members, pursuant to long-term, all-requirements contracts. Pet. 5.[2]

The bankruptcy court appointed petitioner Ralph R. Mabey trustee to manage Cajun's affairs during the reorganization process. Pet. App. 2a; *In re Cajun Elec. Power Coop., Inc.*, 74 F.3d 599, 600 (5th Cir.), cert. denied, 519 U.S. 808 (1996). The trustee sought, and the bankruptcy court authorized, a competitive auction for Cajun, which produced three reorganization bids: (1) the Trustee plan, which proposed a purchase of Cajun's assets by Louisiana Generating LLC; (2) a plan proposed by respondents Southwestern Electric Power Company (Southwestern) and the Committee of Certain Members (Committee), which was an unofficial committee comprised of seven of Cajun's member cooperatives; and (3) a plan submitted by Enron Capital & Trade Resources Corporation and the Official Committee of Unsecured Creditors. Pet. App. 3a, 7a. Disclosure statements for those plans were approved in November 1996, and voting was concluded by December 6, 1996. See *id.* at 6a-7a.[3]

When confirmation hearings began before the bankruptcy court, three of the original Committee members withdrew their support for Southwestern's plan and stated that they wished to change their votes to support the Trustee's plan. Pet. App. 7a. On January 7, 1997, the bankruptcy court disqualified Southwestern's

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[2] Cajun's nuclear assets were disposed of through a separate settlement. See *In re Cajun Elec. Power Coop., Inc.*, 119 F.3d 349 (5th Cir. 1997).

[3] The plan proposed by Enron Capital & Trade Resources Corporation was withdrawn following the court of appeals' ruling in this case. Pet. 7.

counsel due to a conflict of interest. *Ibid.* That evening, Southwestern offered to pay Committee members who had not yet expressed a desire to change their votes the sum of $1 million, with $500,000 payable immediately and the balance payable in approximately one month. *Id.* at 7a-8a. Southwestern characterized the payments as compensation for the transition costs associated with the change of counsel and other processing of the bankruptcy litigation. *Id.* at 8a. The payments were denominated "confidential" (Pet. 7) and were not disclosed to the bankruptcy court or the parties to the proceeding either prior to or at the time of payment (Pet. App. 60a, 87a). Only after the payments were inadvertently disclosed three months later was notice provided. *Id.* at 11a.

2. a. When the payments were discovered, the United States and the Trustee (and other creditors) argued to the bankruptcy court that the payments to the Committee members were improper and should be disgorged because such payments could be made only as part of a confirmed plan of reorganization. See Pet. App. 84a-85a. After conducting a hearing, the bankruptcy court found that the payments "would, in some way, further [Southwestern's] chances of success" in having its reorganization proposal adopted. *Id.* at 86a. The bankruptcy court nevertheless ruled that the payments were permissible "transition assistance." *Id.* at 89a. The bankruptcy court further found that the payments were not conditioned on the Committee members' adherence to a separate agreement to enter into power supply contracts exclusively with Southwestern pending the adoption of a reorganization plan, nor were they intended to buy the Committee members' votes. *Id.* at 86a, 88a. Rather, the court con-

cluded that Southwestern obtained "nothing" in return for its payment of $1 million. *Id.* at 86a.

The court ruled, however, that the payments required its approval under 11 U.S.C. 1129(a)(4).[4] Accordingly, the bankruptcy court ordered Southwestern to file an application for nunc pro tunc approval of the payments. Pet. App. 17a. Southwestern did so, and that application remains pending before the bankruptcy court. See *id.* at 17a, 30a.

b. The district court reversed and referred the matter to the United States Attorney for investigation of possible criminal conduct. Pet. App. 49–74a, 78a-79a.[5] The district court held that the payments by Southwestern to the Committee members were not adequately disclosed and, in fact, were deliberately concealed. *Id.* at 60a, 63a. The court also noted that the payments to the Committee members "coincidentally c[ame] to approximately the amount of money that they had as creditors in this particular case." *Id.* at 69a. In the district court's view, Southwestern was "paying [the Committee members] off in return for their vote." *Id.* at 62a. The district court ordered the payments disgorged and returned to Southwestern, rather than

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[4] That Section provides that a court shall not confirm a Chapter 11 plan of reorganization unless

> [a]ny payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.

11 U.S.C. 1129(a)(4).

[5] The investigation by the United States Attorney's Office is currently inactive.

paid into the bankruptcy estate. *Id.* at 74a. The court also ruled that the improper payments rendered Southwestern's proposed reorganization plan unconfirmable as a matter of law. *Id.* at 73a-74a.[6]

3. The court of appeals reversed. Pet. App. 1a-36a. The court agreed with the bankruptcy court and the district court that payments such as those made by Southwestern must be approved as reasonable under 11 U.S.C. 1129(a)(4). Pet. App. 22a. But the court rejected the district court's conclusion that the payments were improper because they were not approved in advance, holding that the "plain language" of Section 1129 permits retroactive approval. *Ibid.* The court also reversed the district court's determination that the payments were made for an improper purpose, because the bankruptcy court's factual findings that the payments were not for the purpose of buying the members' votes or for locking the members into power supply agreements with Southwestern were deemed to be not clearly erroneous. *Id.* at 25a-29a. The court further held that the bankruptcy court did not abuse its discretion in determining that the payments were adequately disclosed, *id.* at 31a-32a, or clearly err in holding that the payments were made in good faith, *id.* at 35a. Finally, the court of appeals ruled that the payments did not violate the absolute priority rule, 11 U.S.C. 1129(b)(2)(B)(ii), or unfairly discriminate between class members, 11 U.S.C. 1123(a)(4), because the payments

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[6] The district court held that the payments violated numerous statutory provisions, including 11 U.S.C. 1123(a)(4) (discriminatory treatment of creditors), 1125 (disclosure requirements), 1129(a)(3) (improper purpose and bad faith), 1129(a)(4) (failure to obtain prior judicial approval), and 1129(b)(2)(B)(ii) (absolute priority rule). See Pet. App. 18a.

were not derived from assets of the bankruptcy estate. The court accordingly held that Southwestern's plan was not disqualified from confirmation as a matter of law and that the district court erred in ordering disgorgement. Pet. App. 36a.

ARGUMENT

Petitioners seek (Pet. 8-16) this Court's review of the court of appeals' determination that Southwestern's undisclosed payments to certain of Cajun's cooperative members were not legally improper. The United States, which is owed $4.2 billion, is by far the largest creditor in the underlying bankruptcy proceeding. See Pet. 5. As a general matter, the United States shares petitioners' concerns about the secretive payments that Southwestern made only to certain bankruptcy creditors who also happened to be the gatekeepers to Cajun's primary asset (the all-requirements power contracts), and that were made in the wake of the efforts by three other cooperative members to abandon their votes in support of Southwestern's plan. In particular, we agree with petitioners that, at a minimum, it is not conducive to the proper functioning of the bankruptcy process for plan proponents to make payments to interested stakeholders—especially payments that "coincidentally come[] to approximately the amount of money that [the stakeholders] had as creditors in th[e] particular case" (Pet. App. 69a)—that are not properly disclosed to all parties in a timely fashion in accordance with applicable bankruptcy procedures. See, *e.g.*, 11 U.S.C. 1125 (disclosure requirements). For those reasons, the United States, like petitioners, sought rehearing below. While the United States thus disagrees with the court of appeals' ruling, we nevertheless do not

believe that the case merits an exercise of this Court's certiorari jurisdiction for five reasons.

First, the decision does not conflict with the ruling of any other circuit, and petitioners do not seek this Court's review on that basis.[7]

Second, the court of appeals' ruling does not squarely conflict with any decision of this Court. Petitioners are correct (Pet. 9-13) that the court's ruling is in tension with the principles underlying this Court's decision in *United States* v. *Knight*, 336 U.S. 505 (1949). In that case, counsel for a creditor seeking to acquire the debtor's assets made an undisclosed payment of $3000 to the bankruptcy trustee and his attorney while reorganization proceedings were pending. When the payment came to light, it was defended, like Southwestern's payment here, on the ground that it represented services properly rendered in connection with the reorganization. 336 U.S. at 506-507. This Court sustained the convictions for bankruptcy fraud on the

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[7] Petitioners present a third question they wish to argue, in the event the petition is granted, that concerns the consistency of the court of appeals' ruling with the Fourth Circuit's decision in *Official Comm. of Equity Security Holders* v. *Mabey*, 832 F.2d 299 (1987), cert. denied, 485 U.S. 962 (1988). See Pet. i. Petitioners do not, however, claim that the court of appeals' ruling conflicts with that decision. Nor could they. The Fourth Circuit's case concerned the pre-plan distribution by the debtor of what were indisputably assets of the bankruptcy estate to one class of creditors outside the Bankruptcy Code's established priority system. 832 F.2d at 301-302. The question presented in the present case, however, is whether Southwestern's secret payment should have been considered part of the bankruptcy estate in the first instance. The court of appeals here did not question the applicability of the Bankruptcy Code's payment scheme to all assets found to be part of the bankruptcy estate. It simply concluded that the $1 million payment did not fall into that category.

ground that the record permitted a jury to find that the $3000 "was paid in connection with the reorganization," "was paid secretly and in a devious way," and that "the form of the arrangement served only to syphon [funds to the trustee] without court approval." *Id.* at 508. This Court explained:

> All the consideration which is paid for a bankrupt's assets becomes part of the estate. No device or arrangement, however subtle, can subtract or divert any of it. It is the substance of the transaction, not its form, which controls. If that requirement were not rigidly enforced, control of the plan of reorganization * * * would pass from the court to the parties. That would subvert the statutory scheme.

Ibid.

The court of appeals' decision does not squarely conflict with *Knight*. The court of appeals' decision turned upon the factual findings made by the bankruptcy court that (1) the payments came after the members had already voted and thus could not have been for the purpose of buying those votes; (2) the members' votes were not worth buying; (3) the payments were not in exchange for the members' agreement to enter into all-requirements power contracts with Southwestern; and (4) the payments were animated by Southwestern's benign purpose of providing transition assistance following the disqualification of the Committee's bankruptcy counsel. See Pet. App. 25a-29a. While the United States largely disagrees with those factual findings and the inferences that were drawn from them, we recognize that this Court "do[es] not grant a certiorari to review evidence and discuss specific facts." *United States* v. *Johnston*, 268 U.S. 220,

227 (1925). The findings made by the bankruptcy court and accepted by the court of appeals do not correspond to the factual predicate that underlay this Court's ruling in *Knight*. See 336 U.S. 508 (noting that court of appeals' reversal of conviction was "an improper interference with the jury's function" to find the facts surrounding the secretive payment made in that case). Accordingly, no square conflict is presented and this Court's review is not warranted.

Third, we disagree with petitioners' claim (Pet. 13-15) that the court of appeals' decision is inconsistent with this Court's decision in *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197 (1988). In *Ahlers*, this Court addressed the absolute priority rule, 11 U.S.C. 1129(b)(2)(B)(ii), which regulates the allocation of bankruptcy assets when a plan is confirmed over the dissent of an impaired creditor class (a "cramdown plan"). See 485 U.S. at 202. The *Ahlers* Court held that new value contributed in the form of sweat equity, as opposed to money or capital, provides no basis for an exception to the absolute priority rule. *Id.* at 202-209. The present case, however, does not involve any contribution of sweat equity by Southwestern; nor does it involve the confirmation of a cramdown plan. To the contrary, the bankruptcy court has refused to confirm any plan yet in this bankruptcy proceeding, having recently disqualified both petitioners' and Southwestern's proposed plans on other grounds. See *In re Cajun Elec. Power Coop., Inc.*, 230 B.R. 715 (Bankr. M.D. La. 1999); see also Southwestern Br. in Opp. 9.

Nor, contrary to petitioners' claim (Pet. 14-15), does this case overlap in any significant respect with *Bank of America National Trust & Savings Ass'n* v. *203 North LaSalle Street Partnership*, No. 97-1418 (argued Nov. 2, 1998), which is currently pending before this Court.

That case concerns the existence of a new value exception to the absolute priority rule. Because this case does not involve the contribution of new value by junior equity holders under a proposed reorganization plan (as petitioners concede, Pet. 15); does not at this juncture entail review of a plan that has been confirmed by the bankruptcy court (because no plan has yet been confirmed); and, in the view of the bankruptcy judge and the court of appeals, does not concern the distribution of money that was part of the bankruptcy estate, it is highly unlikely that this Court's decision in *Bank of America* could have any material effect on the court of appeals' disposition of this case.

Fourth, and relatedly, the court of appeals' ruling reflects a highly fact-bound and record-specific determination about the character of these particular undisclosed, pre-confirmation payments, in light of their timing and the nature of the recipients' interests. The court of appeals did not hold that other analogous payments made under somewhat different factual circumstances could not be found by a bankruptcy court to be improper under the principles enunciated in *Knight*. Because the court of appeals' decision turns upon the deferential standard of review accorded the bankruptcy court's factual findings and does not announce any broad new exception to traditional rules governing undisclosed payments to interest holders in bankruptcy proceedings, this Court's review is not warranted.

Fifth, the interlocutory character of this proceeding counsels against review at this time. Still pending before the bankruptcy court is Southwestern's application for approval of the payments it made. See Pet. App. 17a, 30a. Should the bankruptcy court ultimately decline to approve the payments at issue here, either in whole or in part, on the ground that the payments were

not "reasonable" within the meaning of 11 U.S.C. 1129(a)(4), the questions presented in the petition would be rendered practically, if not legally, moot.

Furthermore, as previously noted, the bankruptcy court recently issued a new and important series of rulings in the underlying litigation. See *In re Cajun Elec. Power Coop., Inc., supra.* Those rulings held, in pertinent part, that neither of the proposed reorganization plans that were then pending before the court (including the Southwestern plan) was confirmable under applicable provisions of the bankruptcy law, for a variety of reasons wholly independent of the question presented by petitioners. See *ibid.*[8] Two new plans of reorganization were recently submitted for the bankruptcy court's approval. The fact that the proceedings below remain in flux further militates against review by this Court at this time.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[8] Certain aspects of the bankruptcy court's rulings have been appealed to the district court by the United States and other parties to the bankruptcy litigation.